Internal Revenue Service

memorandum

CC:TL-N-5287-90
Br4:WHBaumer

date: MAY 15 1990

to: District Counsel, Houston
Attn: Sheri Wilcox

from: Assistant Chief Counsel (Tax Litigation)

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subject: Request for Tax Litigation Advice
[redacted]

This is in reply to your request for tax litigation advice concerning whether the statute of limitations for the above-named taxpayer with respect to its [redacted] tax years has expired. You indicate that this is a non-docketed C.E.P. case.

On April 12, 1990, the Internal Revenue Service ("IRS") issued summonses to various officers of [redacted] (hereafter "[redacted]") with respect to its examination of the taxable years [redacted]. [redacted] has stated that it will resist enforcement of the summonses on the ground that the statute of limitations for those years has expired. You anticipate that the Department of Justice will file petitions for enforcement no later than [redacted]. As a consequence, the issues addressed in this case will most likely be litigated first in the context of a summons enforcement proceeding, as opposed to a Tax Court proceeding.

ISSUES

(1) Whether the Forms 872 signed by [redacted] for the years [redacted] were conditional upon the issuance of 30-day letters for the years [redacted] one year prior to the expiration of the extended statute of limitations.

(2) Whether the issuance of a 30-day letter for tax years [redacted] prior to the date of the closing agreement satisfies the IRS' obligation to issue such letter.

(3) Whether the issuance of a summons on [redacted], with respect to tax years [redacted], extended the period within which to issue the 30-day letter for those years.

(4) Whether failure to issue a 30-day letter for tax years [redacted] would revive previously issued unrestricted Forms 872-A.

(5) Whether failure to issue 30-day letters for tax years [redacted] would affect the statute of limitations for the remaining tax years, [redacted].

CONCLUSIONS

(1) The Forms 872 signed by [redacted] were independent promises to extend the statute of limitations and were not conditional on the issuance of 30-day letters.

(2) The issuance of a 30-day letter for tax years [redacted] prior to the formation of the closing agreement is pertinent to the determination of whether the breach is a material or immaterial one. If the breach is immaterial, [redacted] is required to perform, i.e., to adhere to its consent to extend the statute of limitations.

(3) The issuance of the [redacted] summons extended the statute of limitations for tax years [redacted] and thereby also extended the due date for the 30-day letter.

(4) Failure by the IRS to issue 30-day letters would probably not revive Forms 872-A issued prior to the closing agreement if the court concludes that those earlier forms were superseded by the Forms 872 issued pursuant to the closing agreement. Because this is a question of intent, it is a factual question to be determined by the trier of facts.

(5) The failure to issue 30-day letters for [redacted] would not affect future years because the future years involve a separate legal action.

FACTS

[redacted] and the IRS entered into a closing agreement in [redacted] in which they agreed to the treatment of certain adjustments, mainly I.R.C. § 482 adjustments, to [redacted]'s income for the years [redacted]. Included in paragraph 7 of the closing agreement was a provision extending the statute of limitations on Forms 872 for the years [redacted] to enable the IRS to complete its examinations of those years. For tax years [redacted] the statute of limitations date was extended to [redacted] and for tax years [redacted] the statute was extended to [redacted].

Paragraph 7 of the closing agreement further provides that in the event the Commissioner determines that it is necessary to issue a summons in connection with the examination of the years [redacted] to [redacted], the taxpayer agrees to execute additional Forms 872 extending the statute of limitations for 90 days plus the number of days from the summons response date to the happening of the earliest of four specified events. Under this provision, [redacted] would be required to extend the statute of limitations for [redacted] to [redacted], at the earliest. In

addition, the Commissioner agrees to issue a 30-day letter to the taxpayer for the years [redacted] to [redacted], inclusive, one year prior to the expiration of the statute of limitations extended as provided above.

The closing agreement was negotiated over several months, with numerous revisions by both parties. The final sentence of paragraph 7, dealing with the issuance of 30-day letters for tax years [redacted], was included in the paragraph based on the request of [redacted]'s counsel. The IRS had factored in a one-year period for consideration by the Appeals Division in computing the time to which the statute of limitations for each year should be extended. [redacted]'s counsel was aware of this when he made his request to add the final sentence to paragraph 7. There was little discussion of the reason for wishing to insert this provision.

DISCUSSION

I.R.C. § 6501(c)(4) provides that the statute of limitations may be extended by agreement in writing before the expiration of the period previously agreed upon.

I.R.C. § 7121 authorize the Secretary to enter into an agreement in writing with any person relating to the liability of such person (or of the person or estate for whom he acts), in respect of any internal revenue tax for any taxable period.

The internal Revenue Service Closing Agreement Handbook, contained in IRM 8(13)10-1, at subsection 121(1), states:

> (1) A closing agreement under I.R.C. § 7121 is, as the name implies, an agreement pursuant to statute. While exhibiting some of the attributes of a contact, it is not controlled by the law of contracts. For example, legal consideration is not requisite to its validity. Neither is it subject to the rules of estoppel. The greatest disparity between the ordinary contract and a closing agreement is the finality accorded the latter by the terms of the statute.

Issue 1

In the instant case, [redacted] intends to raise the statute of limitations as a bar to the summonses issued to the officers of [redacted] on [redacted], with respect to tax years [redacted].

There is a longstanding policy that statutes of limitation barring assessment and collection of federal taxes are strictly

construed in favor of the Government. Badaracco v. Commissioner, 104 S. Ct. 756 (1984); and E. I. Dupont DeNemours & Co. v. Davis, 264 U.S. 456, 462 (1924). Under Rule 142 of the Tax Court Rules of Practice and Procedure, the burden of proof in such matter shall be upon [redacted]. In pleading such issue, [redacted] must show that the summons was issued beyond the applicable statute of limitations. The resolution of this issue depends upon an interpretation of the last sentence of paragraph 7.

Although waivers on Form 872 and closing agreements are not contracts, contract principles are nevertheless important in interpreting them. See Kronish v. Commissioner, 90 T.C. 684 (1988); and Estate of Taft v. commissioner, T. C. Memo. 1989-427.

In interpreting a contract, ambiguities in a provision are construed against the person who drafted the provision. See United States v. Harris Trust and Savings Bank, 390 F.2d 285, 288 (7th Cir. 1968). In this case, [redacted]'s counsel requested the insertion of the last sentence of paragraph 7. As a consequence, we believe that any ambiguity in the interpretation of that provision must be resolved against [redacted].

In addition to the above, it is sometimes said that where the expressions used by the parties are ambiguous, the presumption is that the words are promissory rather than that they create a condition. See 3A Corbin on Contracts §§ 633 and 635. According to the Restatement of Contracts, § 260, promises to perform an act by the person who is to do the act are interpreted, unless a contrary intention has been manifested, as a promise by that person as opposed to a condition.

The distinction between a promise and a condition is aptly illustrated by the classic case of Constable v. Cloberie, Palmer 397 (1626). In that case the plaintiff expressly promised to sail with the next favoring wind with a cargo supplied by the defendant. The latter promised to pay a specified sum if the ship went the intended voyage. The plaintiff succeeded in making the voyage but he failed to keep his promise to sail with the next wind. The court held, nevertheless, that the freight was due and payable. While the plaintiff had breached his promise of sailing with the next wind, that promise was not a condition of the defendant's duty to pay. In short, while starting promptly with the next favorable wind was desirable it was not of vital importance and did not go to the "essence" of the contract.

In deciding whether a provision is a promise as opposed to a condition, courts often resort to the parol evidence rule. According to that rule, parol evidence of prior or contemporaneous negotiations is admissible, even where the parties have adopted the written document as the final and complete expression of their contract, for the purpose of

explaining ambiguous expressions in the writing, and to explain latent ambiguities in the contract. See Simpson, Handbook of the Law of Contracts, 2d ed. (1965), ¶ 101; and Estate of Craft v. Commissioner, 68 T.C. 249 (1977), aff'd per curiam, 608 F.2d 240 (5th Cir. 1979).

Although language in a sentence by itself is unambiguous, its meaning may be susceptible of different explanations when examined in the context of the paragraph or instrument as a whole. In such case, parol evidence is admissible to explain the ambiguity. A promise to perform an act, without further explanation, may often create differences of opinion as to how and when that act should be performed. In the classic case of Stoops v. Smith, 100 Mass. 63 (1863), a promise "to publish an advertising chart" was considered to be ambiguous both as to the promised performance of publishing and also as to what it was that was to be published. Evidence of the parties' antecedent understandings and negotiations was allowed to resolve the ambiguity.

Evidence of an established standard operating procedure in an organization or of custom and usage in a trade or business is admissible to attach a special meaning to one of the terms expressed. In framing closing agreements, the standard operating procedure of the Service is to avoid contingencies that would preclude a closing agreement from taking effect or remaining in effect. Occasionally a taxpayer will submit a closing agreement with a letter stating that the submission of the agreement is conditioned upon some other action. Ordinarily the agreement should not be accepted unless a letter is received withdrawing the condition. See 8(13)10-1 at subsection 34(12) and section 6.14 of Rev. Proc. 68-16, 1968-1 C.B. 770.

In the present case, the fact that the instructions relating to the formation of a closing agreement caution against including contingencies in an agreement is objective evidence that the Service representatives, in this case, viewed the promise to issue a 30-day letter one year before the expiration of the statute of limitations as a promise and not a condition. In conjunction with the presumptions favoring a promise over a condition and construing a term against the party that inserts it, we are inclined to believe the Service will prevail in its arguments even if [redacted] presents parol evidence rebutting the Service's arguments.

According to Corbin, the non-fulfillment of a promise creates in the other party a secondary right to damages. Where legal remedies of damages and restitution are inadequate, a plaintiff may seek the remedy of specific performance. A decree for specific performance takes the form of a decree ordering a party affirmatively to carry out his contractual duties or enjoining

him from acting where he has a duty of forbearance. See Calamari and Perillo, The Law of Contracts, 3rd ed. (1987), § 16-1. In this case, the duty to issue a 30-day letter for tax years 1980-81 was breached by the Service. Since time is not of the essence, money damages would undoubtedly be inadequate. Therefore, should [redacted] seek specific performance, we believe the Service should concede that [redacted] should have a right to present their case before the Appeals Office prior to issuance of a notice of deficiency.

Issue 2

With respect to tax years [redacted], you believe an argument can be made that the promise to issue a 30-day letter was met. The IRS issued a 30-day letter to [redacted] for the years [redacted] on [redacted]. The weaknesses in this argument are twofold: first, the 30-day letter was issued before the closing agreement was signed; and second, the IRS raised one new issue after the [redacted] 30-day letter.

According to Calamari and Perillo, where a party fails to perform a promise, it is important to determine if the breach is material. If so, the aggrieved party may cancel the contract. If the breach is immaterial, the aggrieved party may not cancel the contract but may sue for a partial breach. The Law of Contracts, §§ 11-15 and 11-18.

In the instant case, we have concluded that language relating to issuance of a 30-day letter is promissory rather than conditional. Therefore, the question arises whether a material breach has occurred. You rightly point out that the purpose of the promise has been fulfilled. The only issue that arose after the closing agreement was signed was one dealing with captive insurance. That issue was an Appeals coordinated issue. As a consequence, the Appeals Division had no authority to settle that issue, other than by asking for 100 percent concession by the taxpayer. The net result was that there was no point in issuing a second 30-day letter since Appeals had no authority to consider the issue. We agree that it is important to raise these arguments in order to show that the failure to issue the 30-day letter was immaterial. Based upon the above, we have no objection to your arguing that the promise to issue the 30-day letter was, in substance, met.

You also indicate that [redacted]'s Vice President for Taxes and the IRS group manager agreed orally to forego issuing a second 30-day letter for [redacted]. If this is so, [redacted] waived the right to such letter. We definitely feel the waiver argument should be raised in this case.

Issue 3

With respect to tax years [redacted], you argue that the issuance of summonses to [redacted]'s four officers requires [redacted], pursuant to paragraph 7 of the closing agreement, to extend the statute of limitations to at least [redacted]. We agree. The literal language of paragraph 7 permits the Service to extend the statute of limitations by issuance of a summons. Since the time period for issuing the 30-day letter is based on the statute of limitations, such period must necessarily be also extended.

The purpose of getting a 30-day letter one year prior to the expiration of the statute of limitations is to crystalize the issues and provide an opportunity for due deliberation by the Appeals Office. Extension of the statute of limitations for whatever reason insures that the taxpayer will get the hearing he desires before the Appeals Office. Accordingly, we believe the Service's promise to issue a 30-day letter one year prior to expiration of the statute of limitations has been met assuming that a 30-day letter was, in fact, issued to [redacted] on or before [redacted].

Issue 4

With respect to tax years [redacted], you argue that the earlier issued Forms 872-A would revive if the court invalidates the Forms 872 executed pursuant to the closing agreement.

At this point the question arises whether the alleged condition to issue 30-day letters is a act which must occur before a party is obliged to perform in an existing contract or whether it is an act which must occur before formation of the contract. Calamari and Perillo indicate that it is difficult in a concrete case to distinguish a condition precedent to the formation of a contract from a condition precedent to the performance of a contract. The distinction is further complicated by the doctrine of divisibility discussed below in issue 5. We have no objection to your arguing that the promise to issue 30-day letters, if construed to be a condition, is a condition precedent to the formation of the agreement and that, under the doctrine of divisibility, the agreement in question comprises paragraph 7.

If the court ultimately concludes that the whole of paragraph 7 is invalidated, the next question to resolve is whether the earlier issued Forms 872-A are revived. This depends upon whether the parties intended to supersede the Forms 872-A with the new Forms 872.

GCM 39376, I-115-85 (1985), discusses the question of whether a subsequent restricted Form 872-A, Special Consent to Extend the

Time to Assess Tax, supersedes a prior unrestricted Form 872-A. The central inquiry focuses on whether the parties intended that the subsequent consent supersede the prior consent. See, for example, Ethel D. Co. v. Commissioner, 27 BTA 25 (1932), aff'd, 70 F.2d 761 (D.C. Cir. 1934); and Farmers Union State Exchange, 30 BTA 1051 (1934), acq., XIII-2 C.B. 7 (1934).

You have cited the case of Podell v. Commissioner, T.C. Memo. 1987-22, in support of your argument. In that case, two separate offices simultaneously sought the execution of the Form 872-A. We believe the fact that the offices were unaware of each other's action makes the case distinguishable from the situation here. You suggest that the only way a taxpayer can revoke a prior consent is to execute a Form 872-T because this is the only prescribed avenue for termination of a consent in the Form 872. Under your argument, termination of a consent is not possible by a closing agreement unless the agreement requires execution of a Form 872-T. We believe that a Form 872 is nothing more than a consent agreement. We find nothing inherently wrong with modifying an agreement with another agreement, especially if that latter agreement is a closing agreement.

In view of the above, we are inclined to believe that the court will conclude that the previously issued Forms 872-A cannot be resuscitated. Nevertheless, we have no objection to your arguing that invalidation of the promise revives the status quo, namely the validity of the earlier Forms 872-A. Because this is a question of intent, it is essentially a factual matter to be decided by the trier of the facts.

Issue 5

You argue that the failure by the Service to issue a 30-day letter with respect to tax years [redacted] should not invalidate all of the Forms 872 for tax years [redacted] because each taxable year should stand on its own. We agree.

The question to be resolved here is whether paragraph 7 is a divisible agreement. A contract is said to be divisible if "performance by each party is divided into two or more parts" and "performance of each part by each party is the agreed exchange for a corresponding part by the other party." Howard University v. Durham, 408 A.2d 1216 (D.C. 1979); Restatement, Second, Contracts § 266; and 3A Corbin § 694.

It is often said that whether a contract is divisible is a question of interpretation or one of the intention of the parties. Blakesley v. Johnson, 227 Kan. 495, 608 P.2d 908 (D.C. 1980). It is rare that the parties express an intention on the issue of divisibility. The test ultimately appears to be whether, had the parties thought about it as fair and reasonable

people, they would be willing to exchange the performance in question irrespective of what transpired subsequently. Calamari and Perillo, The Law of Contracts, § 11-23.

In the instant case, it is reasonable to expect that failure to provide 30-day letters with respect to tax years [redacted] if in fact that is determined to be a condition, would invalidate the consent on Forms 872 with respect to those years only. Accordingly, in such situation, the Forms executed for the years subsequent to [redacted] would not be affected.

Summons Enforcement

On [redacted], the Service issued summonses to officers of [redacted] with respect to its examination of taxable years [redacted] and [redacted]. [redacted] has indicated that its officers will resist compliance with the summonses on the grounds that the period of limitations on assessment for these years has expired. In light of this development, we have coordinated your request with the General Litigation Division.

The basic criteria for judicial enforcement of an IRS summons are set forth in United States v. Powell, 379 U.S. 48, 57-58 (1964), which requires that the Government make an initial showing:

> [T]hat the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner's possession, and that the administrative steps required by the Code have been followed.

It is [redacted]'s position that the Form 872 executed for tax years [redacted] is no longer effective and that the period of limitations on assessment with respect to those years has passed. If [redacted] is correct, it would be difficult to sustain the summonses on grounds that the investigation for those years was being conducted pursuant to a legitimate purpose. The success of the summons enforcement proceeding will therefore turn on the question of whether the Form 872 for tax years [redacted] has been invalidated. The Chief of Branch 1 of the General Litigation Division has informed us that his office is available to provide whatever assistance is necessary in regards to a summons enforcement proceeding.

If you have any questions concerning the above, please contact William Baumer at FTS 566-3325.

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